

## **Pennsylvania Supreme Court Rules that Electricity Distribution, Transmission and Transition Charges are Subject to Sales Tax**

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On November 5, 2009, in *Spectrum Arena Limited Partnership v. Commonwealth*, 983 A.2d 641 (Pa. 2009), the Pennsylvania Supreme Court affirmed the April 2008 decision of the Commonwealth Court that distribution, transmission and transition charges associated with the purchase of electricity for non-residential purposes ("Delivery Charges") are subject to Pennsylvania Sales Tax. Numerous refund claims had been filed by commercial electricity users seeking a refund of sales tax paid on Delivery Charges in cases where the electricity charges had been "unbundled," i.e., one utility company generated the electricity purchased by the consumer and another "local" utility company delivered the electricity to the consumer through its power lines.

Prior to enactment of the Electricity Generation Customer Choice and Competition Act ("Competition Act"), local electric utility companies generated electricity and distributed that electricity directly to consumers located within the geographical area served by that utility. Costs associated with the generation and distribution of electricity were presented to the consumer with a single amalgamated cost for the amount of electricity provided. Due to the "bundled" nature of the charges for electricity service, the entire cost of generation, transmission and distribution was subject to sales tax. The Competition Act broke up the local utility company's monopoly over the generation of electricity by allowing consumers to purchase electricity from any supplier. However, for obvious practical reasons, the Competition Act maintained transmission and distribution as services on which the local utility could continue to hold a natural monopoly subject to the supervision of the Public Utility Commission.

Spectrum Arena had argued that the Delivery Charges imposed by the local utility company were not subject to sales tax because they were not taxable charges for "electricity for nonresidential use" and did not otherwise qualify as charges for tangible personal property or as a specifically enumerated taxable service. In addition to statutory construction arguments, Spectrum Arena relied, in part, on the fact that the Department of Revenue's regulations exempt delivery charges from sales tax when billed by a party other than the vendor supplying the product. In rejecting Spectrum Arena's arguments, the Court determined that the generation and distribution companies were "together" the "vendor," and there was "no truly independent electricity delivery company" as contemplated by the Department's regulations at 61 Pa. Code §54.1(c). The Court also adopted the position that electricity is not a finished product, "capable of sale at retail," until it is both generated and delivered to the consumer. Thus, the Court determined that the Delivery Charges are part of the purchase price of electricity and not "independent" delivery charges. Unfortunately, in reaching its conclusion regarding the proper statutory interpretation, the Court, in several instances, mistakenly characterized statutory references to the Tax Reform Code as references to the Competition Act. The Court also seemed to equate the definition of "sales of electric energy" for Utilities Gross Receipts Tax purposes with the definition of "sale at retail" of "electricity for nonresidential use" for Sales Tax purposes, when those two taxes are governed by different sections of the Tax Reform Code.

Spectrum Arena had further contended that applying sales tax to the Delivery Charges, but not to similar charges for the delivery of natural gas, created an improper disparate tax scheme. The Court rejected this argument on the basis that the Department of Revenue's Policy Statement regarding the taxability of unbundled electricity charges demonstrates the legislature's intention to apply a different tax treatment to electricity delivery charges. The Court's analysis on this point

seems weak - it simply construed the content of a Policy Statement issued by the Department of Revenue as evidence of the legislature's intention to implement a disparate tax scheme for "unbundled" delivery charges for electricity and natural gas, with no further citation to authority or factual support.

Since Spectrum Arena did not file an application for reargument of the case, the Supreme Court's decision has become final.

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